

I. INTRODUCTION

A. Background

In California, the responsibility for regulating public water systems and overseeing the safety of drinking water rests with the Department of Health Services (Department). The Department has been designated as the “primacy agency” by the United States Environmental Protection Agency (USEPA) for purposes of implementing and enforcing the federal Safe Drinking Water Act (SDWA). The Department regulates over 8,700 public water systems located throughout the State. To assist in this effort, the Department contracts with 34 of the 58 counties in the State for enforcement of the State drinking water requirements for public water systems serving less than 200 service connections.

Many California water systems are having difficulty in complying with the numerous new drinking water standards and requirements due to the lack of sufficient financial resources. In addition to the many compliance needs, many systems also face the need to improve their source water capacity and treatment plants, replace old or inadequate pipelines and equipment, and improve their managerial and technical capability. The magnitude of these needs is reflected in the Drinking Water Infrastructure Needs Survey conducted by the USEPA in 1995. The initial survey indicated that California water systems would require approximately \$18.8 billion to make these necessary improvements. California is presently participating in the USEPA’s effort to update the original needs survey. The conclusion of the 1999 Drinking Water Infrastructure Needs Survey should be available in 2001, and will provide the basis for California’s future federal SRF funding allocation

In response to the national need, Congress in 1996 adopted amendments to the federal SDWA that included funding to provide financial assistance to public water systems. This financial assistance is in the form of Capitalization Grants to states to establish drinking water state revolving funds (DWSRF) to be used to provide low interest loans and other assistance to public water systems. These funds may be used to finance the costs of infrastructure improvements needed to achieve or maintain compliance with the SDWA requirements. In order to receive these funds, states must have statutory authority and must provide a state match equal to 20 percent of the federal Capitalization Grants, which have been authorized through the year 2003. The preliminary indication is that federal funding for the DWSRF will continue beyond 2003.

The initial grant allotments to states for the 2000 fiscal year have been made. The amount of \$83,993,100 has been reserved for allotment to California for the fiscal year 2000.

The federal law provides that a portion of the federal funds may be used for specified activities in addition to providing financial assistance to public water systems for infrastructure improvements. These activities include: (1) administration of the DWSRF financial assistance program, (2) technical assistance to small water systems, (3) source water assessment and protection, and (4) water system capacity development. Federal and state statutes mandate source water assessment and protection and capacity development. Collectively, funding for these “set-aside” programs may utilize up to 31 percent of the federal Capitalization Grant. In order to provide as much funding to public water systems infrastructure improvements as possible, the Department intends to use 95 percent of the federal grant allocation for DWSRF

project funding and to direct the remaining 5 percent to the source water protection loan program. However the Department proposes to reserve the authority to utilize \$5,375,558 (6.4 percent of the FFY 2000 federal allocation) at a future time for specific set aside programs. Thus, while the state would utilize the full amount of the FFY 2000 federal grant for SRF projects presently in need of funding, the Department could seek approval at a future time to utilize \$5,375,558 in future federal DWSRF funds allocated to California for set aside activities. The specific activities would be described in a workplan developed in conjunction with the proposal to utilize the reserved set aside authority. The Department will apply to reserve (bank) the authority to utilize the equivalent of 6.4 percent of the FFY 2000 funds for certain set aside activities in the future, if needed.

To receive funding approval from the USEPA, the State is required to submit a Capitalization Grant application and an Intended Use Plan. Federal guidelines require that the Intended Use Plan include a description of how the program is structured, the planned use of the funds, the criteria, and methods to be used for distribution of the funds, the goals for the program, and a specific Project Priority List. The California Intended Use Plan for the FFY 2000-01 allocation described in this document is being submitted in compliance with those requirements.

B. Statutory Authority

In order to be eligible to receive the federal funds, the California Legislature adopted SB 1307 (Chapter 734, statutes of 1997), which was signed by the Governor on October 6, 1997. This law provides the statutory authority to create the Safe Drinking Water State Revolving Fund (DWSRF) and designates the Department as the state agency responsible for administration of the DWSRF. With only minor differences, the state statute parallels the federal law and requirements. Therefore the federal law and the USEPA DWSRF program guidelines generally govern the conduct of the program. The specific provisions of SB 1307 are set forth in sections 116760.20 through 116762.60 of the California Health and Safety Code (H&S Code). To aid in implementation of this authority, the Department has adopted SRF program regulations, which are set forth in sections 63000 through 63057 of the California Code of Regulations. A copy of these regulations is attached as **Appendix A**. The Department is beginning a Source Water Protection Project loan program during FY 2000-01. Proposed state regulations related to implementation of that program are included as **Appendix B**.

C. Program Structure

The California DWSRF program is administered and directed by the Department. Department staff conduct many of the activities associated with implementation of the DWSRF program, however the Department contracts with other State and local agencies and independent contractors for specific activities. Through an interagency agreement (contract) the California Department of Water Resources provides assistance in administering the local financial assistance portion of the DWSRF program. The Department of Water Resources (1) conducts the financial review of project applications, (2) determines the ability of the applicant to repay the loan, (3) determines the amount of loan subsidy, if any, (4) establishes the terms and conditions of loan contracts, and (5) collects and deposits loan repayments. The Department selected the Department of Water Resources to conduct these activities because of their extensive experience and expertise in carrying out similar activities under previous drinking water bond acts and other water related financial assistance programs. The initial interagency

agreement between the Department and DWR covered 1998 through 2001. During SFY 2000-2001 the Department and DWR will review the agreement in anticipation of continuing the partnership. A copy of the existing interagency agreement between the two departments is included as **Appendix C**.

The Department contracts with the Bureau of State Audits to conduct the annual audit of the Drinking Water State Revolving Fund program. A copy of the interagency agreement between the Department and the Bureau is included as **Appendix D**.

The DWSRF program is managed by the Drinking Water State Revolving Fund Section within the Department's Division of Drinking Water and Environmental Management. The DWSRF section chief serves as the program manager, and provides direction and coordination of various aspects of the DWSRF program and assurance of compliance with federal cross-cutters, particularly the environmental cross cutters. The section chief/program manager is also responsible for assuring statewide consistency in the implementation of the program. The ranking of projects on the priority list and the management of individual projects (technical review of applications, approval of plans and specifications, construction inspections, etc.) is the responsibility of the Department's drinking water program field offices. The relationship of the various DWSRF program activities and responsibilities is illustrated in Figure 1.

II. DRINKING WATER STATE REVOLVING FUND PROGRAM GOALS

The SDWA Amendments of 1996 (Public Law 104-182), enacted in the summer of 1996, authorized the creation of a drinking water state revolving fund (DWSRF). While the Clean Water SRF has been in place to fund wastewater treatment for some time, this was the first time Congress provided a DWSRF for public water system infrastructure needs and other drinking water programs. The DWSRF was authorized in response to many factors, some of which were the amount of public water system infrastructure needs demonstrated nationally by the 1995 EPA Needs Survey and the new SDWA requirements set forth in the amendments.

The DWSRF program goals set forth below reflect both federal and state legislative intent to provide funding to correct public water systems deficiencies based upon a prioritized funding system. The California DWSRF funding system utilizes a comprehensive multi-year Project Priority List (See Section VI, Project Priority List), whereby (1) public water systems projects addressing public health risk problems, (2) public water systems projects needed to comply with the SDWA, and (3) projects assisting public water systems most in need on a per household affordability basis, receive higher funding priority than other eligible public water systems projects.

In general, the DWSRF provides the over 8,700 public water systems in California the opportunity to utilize subsidized funding to correct infrastructure problems, to assess and protect source water, and to improve technical, managerial and financial capability. The DWSRF additionally benefits the nearly 8,300 small water systems (water systems serving a population of fewer than 10,000) by providing funding for technical assistance in most aspects of public water system operations and management, and by assisting with the training and certification costs for operators of small community and nontransient noncommunity water systems.

A. Short Term Goals

1. Maintain an efficient and effective Safe Drinking Water SRF program for the State of California through planned evaluation and revision of the program.

The Department has developed the DWSRF program based on its own experience regulating public water systems, on the knowledge and experience of the drinking water industry and based on the considerable public input received. Public meetings were noticed and held at multiple locations throughout the state. The purpose of these meetings was to obtain public comment and gain support for the DWSRF program. The Department established task force groups and committees of interested agencies, groups, and individuals to provide direction regarding program development. The Department also meets regularly with the USEPA Region IX staff to discuss its DWSRF program development activities. As the Department is beginning the third year of the program, a period of program evaluation and modification in response to identified areas requiring improvement is now appropriate, as standard procedures and processes for implementation of the program have been established.

2. Continue Implementation of the DWSRF program

The first step in the process of implementing the DWSRF program was the passage of the DWSRF enabling legislation (Senate Bill 1307). The Department is now in the process of applying for the Federal Capitalization Grant from the FFY 2000 allocation. The Capitalization Grant application will be submitted to USEPA on or before September 1, 2000. The 20 percent state fund match will be provided from general obligation bond authority available to the California Drinking Water State Revolving Fund Program as the result of the passage by voters on March 7, 2000 of Proposition 13, The Safe Drinking Water, Clean Water, Watershed Protection, and Water Reliability Bond Act. That ballot measure provided for the sale of \$1.97 billion in general obligation bonds for water related projects, including \$70 million for the Safe Drinking Water SRF loan program. The state budget for SFY 2000-01 provides the Department with the authority to apply for and utilize the FFY 2000 DWSRF funding for California.

3. Maintain a Project Priority List and an Intended Use Plan (IUP)

The Department notified every eligible public water system in the state of the proposed DWSRF loan program and invited pre-applications for eligible projects. During the initial pre-application period, a series of public workshops were held to discuss the pre-application process. The staff in the Department's district offices evaluated each project and placed them in the appropriate health risk category. Bonus points were assigned based on the criteria developed by the Department (see Section VI Project Priority List). Regional Engineers and other departmental staff reviewed the Project Priority list before its publication to ensure that the rating of the projects was consistent. The ranked listing of pre-applications was compiled into a Project Priority List. In 1999, the Department provided all public water systems with the opportunity to submit additional projects or update the information on projects already listed. The Department held two public hearings in January 2000 on the draft 1999 Updated Project Priority List for the Drinking Water SRF and adopted the 1999 updated listing effective April 11, 2000. In addition, the Department has invited community water systems and certain non-profit non-community water systems to submit pre-applications for the Source Water Protection Project loan program priority list. The Department evaluated and ranked the proposed Source Water Protection (SWP)

projects, established a draft SWP project priority list, and included this list in the public hearing on the proposed list. The SWP Project Priority List was adopted effective April 11, 2000.

4. Determine the fundable portion of the Project Priority list and invite eligible public water systems to apply for funding

An important goal of the DWSRF program is to fund those projects that are in high priority categories. As discussed in Section VI, Project Priority List, the categories A through G are high priority categories. These categories contain projects to mitigate a current risk to public health or to correct a violation of the SDWA. The Department plans to invite applications from eligible projects on the fundable list on a quarterly basis beginning in April 2000 until the positive Statement of Interest responses reach the level to enable the program to obligate the 1999 Capitalization Grant and State match, as well as any payments made to the SRF fund from previous loans.

5. Develop and implement the set-aside programs

As mentioned earlier in this Section, and discussed in detail in Section IV, Set-Aside Activities, the Department utilizes portions of the Capitalization Grant to fund technical assistance and capacity development programs. The Department implements these programs both by providing direct assistance to water systems, and by supporting local health department (LHD) staff and outside providers to assist smaller water systems in meeting technical, managerial, and financial operations goals, and aid to these systems in applying for SRF loan funds.

B. LONG TERM GOALS

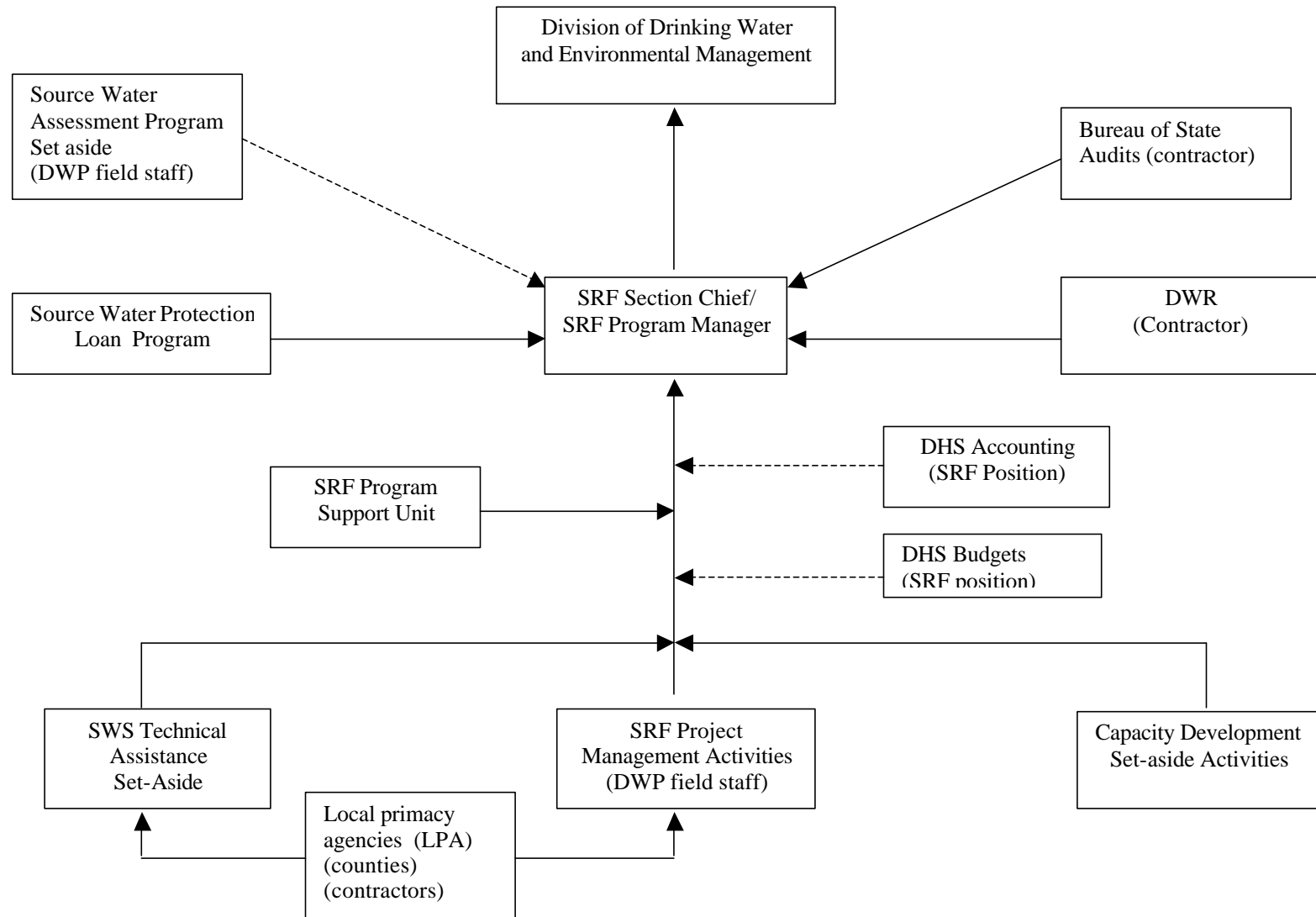
1. Ensure that public water systems provide an adequate, reliable supply of safe, clean drinking water.

A viable DWSRF loan program will advance this basic goal of the Department by providing an ongoing source of funds for future infrastructure improvements.

2. Continue funding projects on the comprehensive, multi-year Project Priority List

The Department will continue to use the priority list process to direct DWSRF loan funds to those projects that meet high priority needs. The Project Priority List developed by the Department for the Capitalization Grant will be revised at least biennially to include new projects. Projects by-passed will not be removed from the list; rather by-passed projects will be eligible for funding in subsequent years at the same time as new projects in the same category.

Figure 1
Drinking Water SRF Program Activities and Responsibilities



3. Ensure the revolving nature of the DWSRF loan fund

The DWSRF loan fund can provide a cost effective funding mechanism to assist public water systems in achieving and maintaining compliance with the SDWA. The Department will monitor the fund to ensure that it remains financially viable over the long term as an ongoing source of water system infrastructure funding. As repayments become available they will allow the issuance of new loans even in the event that further federal Capitalization Grants cease.

4. Ensure that all public water systems achieve and maintain compliance with the SDWA

In furtherance of the Department's overall goal of ensuring safe and reliable drinking water, the Department utilizes the resources of the DWSRF loan fund and set aside programs to help public water systems achieve technical, managerial, and financial capacity to operate in compliance with the SDWA. Important elements of this include enhancing the technical knowledge of small water system personnel in compliance with regulatory requirements, and enhancing the technical knowledge of small water system operators in water treatment.

5. Reduce Cost of Drinking Water

Reduce the per-household cost to public water systems of protecting public health and delivering safe drinking water by:

- a) Using the SWAP results to develop public water system drinking water monitoring plans based on the conditions surrounding the source water and,
- b) Providing affordable financing for the construction of technically sound drinking water infrastructure and source water protection projects.

III. INTENDED USE OF DWSRF FINANCIAL ASSISTANCE FUNDS

The Introduction to EPA's DWSRF Program Guidelines states:

"The Safe Drinking Water Act (SDWA) Amendments of 1996 (Pub. L. 104-182) authorizes a Drinking Water State Revolving Fund (DWSRF) to assist public water systems to finance the costs of infrastructure needed to achieve or maintain compliance with SDWA requirements and to protect public health objectives of the Act. Section 1452 authorizes the Administrator of the U.S. Environmental Protection Agency to award Capitalization Grants to the States, which in turn can provide low cost loans and other types of assistance to eligible systems."

The SDWA requires that states contribute a minimum match of 20 percent of the total Capitalization Grant award each year of the program. This section identifies the source of the required state match and describes the intended use of the DWSRF funds.

**Financial Status of DSWRF
State Fiscal Year 1998-99**

(California DWSRF Program Year 1)

ACCOUNT	FEDERAL FUNDING	STATE MATCH	LEVERAGING	OTHER STATE PROGRAMS	REPAYMENTS & EARNINGS	TOTAL
I. DWSRF Loan Account	\$ 63,270,653	\$ 15,136,520	N/A	\$0	\$0	\$ 78,407,173
Large systems						
Standard Loans	\$27,786,133	\$6,645,259				\$34,431,392
Disadvantaged Communities						
0% Loan	\$23,775,020	\$5,685,971				\$29,460,991
Principle Forgiveness (grant)	\$0	\$0				\$0
Large systems subtotal	\$51,561,153	\$12,331,230				\$63,892,383
Small Systems						
Standard Loans	\$8,102,892	\$1,937,866				\$10,040,758
Disadvantaged Communities						
0% Loan	\$1,699,568	\$406,464				\$2,106,032
Principle Forgiveness (grant)	\$1,910,976	\$457,024				\$2,368,000
Small Systems Subtotal	\$11,713,436	\$2,801,354				\$14,514,790
Loan Account Subtotal	\$63,274,589	\$15,132,584				\$78,407,173
II. Set Aside Accounts		\$0	N/A	N/A	N/A	
Technical Assistance	\$ 1,513,652	0				\$ 1,513,652
State Program Management	\$0					\$0
Capacity Development#	\$ 302,730					\$ 302,730
Local Assistance	\$0					\$0
Source Water Assessment Program	\$ 7,568,260					\$ 7,568,260
Source Water Protection Loan Program	\$0					\$0
Set aside Subtotal	\$ 9,384,642					\$ 9,384,642
III. DWSRF Administration Account						
4% Set aside	\$ 3,027,304					
Fees	N/A	NA	N/A	N/A	N/A	
Subtotal	\$ 3,027,304					\$ 3,027,304
TOTAL	\$75,682,600	\$15,136,520	N/A	N/A	\$0	\$90,819,120

1:1 match from previous PWSS grant overmatch

Financial Status of DSWRF
State Fiscal Year 1999-2000
California DWSRF Program Year 2

ACCOUNT	FEDERAL FUNDING	STATE MATCH	LEVERAGING	OTHER STATE PROGRAMS	REPAYMENTS & EARNINGS	TOTAL
I. DWSRF Loan Account	\$ 72,173,000	\$ 15,421,620	N/A	\$0	\$0	\$ 87,594,620
Large systems						\$ 50,100,000
Standard Loans	\$20,112,231	\$4,295,816				\$24,408,047
Disadvantaged Communities						\$0
0% Loan						\$0
Principle Forgiveness (grant)						\$0
Large systems subtotal	\$20,112,231	\$4,295,816				\$24,408,047
Small Systems						\$3,500,000
Standard Loans	\$752,867	\$160,807				\$913,674
Disadvantaged Communities						
0% Loan	\$5,591,750	\$1,194,354				\$6,786,104
Principle Forgiveness (grant)	\$1,536,896	\$328,269				\$1,865,165
Small Systems Subtotal	\$7,881,513	\$1,683,430				\$9,564,943
Loan Account Subtotal	\$27,993,744	\$5,979,246				\$33,972,990
II. Set Aside Accounts		\$0	N/A	N/A	N/A	
Technical Assistance	\$ 1,542,164					\$ 1,542,164
State Program Management	\$0					\$0
Capacity Development#	\$ 308,433					\$ 308,433
Local Assistance	\$0					\$0
Source Water Assessment Program	\$0					\$0
Source Water Protection Loan Program	\$0					\$0
Set aside Subtotal	\$ 1,850,597					\$ 1,850,597
III. DWSRF Administration Account						
4% Set aside	\$ 3,084,328					
Fees	N/A	NA	N/A	N/A	N/A	
Subtotal	\$ 3,084,328					\$ 3,084,328
TOTAL	\$77,107,925	\$15,421,620	N/A	N/A	\$0	\$92,529,545

1:1 match from previous PWSS grant overmatch

I

\$000 funds still to be obligated indicated as shaded

Financial Plan DWSRF
State Fiscal Year 2000-01
California DWSRF Program Year 3

ACCOUNT	FEDERAL FUNDING	STATE MATCH	LEVERAGING	OTHER STATE PROGRAMS	REPAYMENTS & EARNINGS	TOTAL
I. DWSRF Loan Account	\$71,603,596	\$16,163,340	N/A	\$0	\$0	\$87,766,936
Large systems						
Standard Loans						
Disadvantaged Communities						
0% Loan						
Principle Forgiveness (grant)						
Large systems subtotal	<i>\$60,863,057</i>	<i>\$13,738,839</i>				<i>\$74,601,896</i>
Small Systems(15% target)						
Standard Loans						
Disadvantaged Communities						
0% Loan						
Principle Forgiveness (grant)						
Small Systems Subtotal	<i>\$10,740,539</i>	<i>\$2,424,501</i>				<i>\$13,165,040</i>
Loan Account Subtotal	\$71,603,596	\$16,163,340				\$87,766,936
II. Set Aside Accounts		\$0	N/A	N/A	N/A	
Technical Assistance	\$1,616,334					\$1,616,334
State Program Management	\$0					\$0
Capacity Development#	\$323,267					\$323,267
Local Assistance	\$0					\$0
Source Water Assessment Program	\$0					\$0
Source Water Protection Loan Program	\$4,040,835					\$4,040,835
Set aside Subtotal	\$5,980,436					\$5,980,436
III. DWSRF Administration Account						
4% Set aside	\$3,232,668					
Fees	N/A	NA	N/A	N/A	N/A	
Subtotal	\$3,232,668					\$3,232,668
TOTAL	\$80,816,700	\$16,163,340	N/A	N/A	\$0	\$96,980,040

1:1 match from overmatch for PWSS grant .

\$00.000

shaded areas indicate target allocation of loan funds

Proposed Financial Plan DWSRF
State Fiscal Year 2000-01 Grant Application No.2 (Prop 13)
California DWSRF Program Year 4 (catch-up)

ACCOUNT	FEDERAL FUNDING	STATE MATCH	LEVERAGING	OTHER STATE PROGRAMS	REPAYMENTS & EARNINGS	TOTAL
I. DWSRF Loan Account	\$79,793,445	\$16,798,620	N/A	\$0	\$0	\$96,592,065
Large systems						
Standard Loans						
Disadvantaged Communities						
0% Loan						
Principle Forgiveness (grant)						
Large systems subtotal	\$67,824,428	\$14,278,827				\$82,103,255
Small Systems(15% target)						
Standard Loans						
Disadvantaged Communities						
0% Loan						
Principle Forgiveness (grant)						
Small Systems Subtotal	\$11,969,017	\$2,519,793				\$14,488,810
Loan Account Subtotal	\$79,793,445	\$16,798,620				\$96,592,065
II. Set Aside Accounts		\$0	N/A	N/A	N/A	
Technical Assistance	\$0					\$0
State Program Management	\$0					\$0
Capacity Development	\$0					\$0
Local Assistance	\$0					\$0
Source Water Assessment Program	\$0					\$0
Source Water Protection Loan Program	\$4,199,655					\$4,199,655
Set aside Subtotal	\$0					\$4,199,655
III. DWSRF Administration Account						
4% Set aside	\$0					
Fees	N/A	NA	N/A	N/A	N/A	
Subtotal	\$0					\$0
TOTAL	\$83,993,100	\$16,798,620	N/A	N/A	\$0	\$100,791,720

1:1 match from overmatch for PWSS grant .

\$00.000

shaded areas indicate target allocation of loan funds

A. State Matching Funds

The State of California will provide the required 20 percent from the \$70 million allocated to the Safe Drinking Water State Revolving Fund program from the bonds authorized by Prop 13. Bonds will be sold to provide the required \$16,798,620. Authority to access and expend these funds has been provided in the State budget for DWSRF program for 2000-01.

B. Proposed Uses

The federal allocation to the State of California is \$83,993,100 for FY 2000. From the FFY 2000 Capitalization Grant, the Department plans to set aside for special purpose as follows: \$4,199,655 (5%) for source water protection loans. This will leave the DWSRF loan fund the balance, or \$79,793,445, plus the state match (\$16,798,620) for SRF project funding. The Department plans to bank the authority to utilize SRF funds for set aside activities in future years (for example, at a time when additional set aside funds are no longer allowed, or when a new regulatory activity impacts the drinking water regulatory program) as follows: \$3,359,724 (4%) for Administration, \$1,679,862 (2%) for Small Water Systems Technical Assistance and \$335,972 (0.4%) for Capacity Development.

Any repayments (either principle or interest) made to the DWSRF from previous loan recipients will become available for re-obligation. The Department anticipates re-obligating funds within eighteen months of payment receipt, or as soon as aggregate repayments are sufficient to fund a reachable project.

Table 1.

FFY 2000 Funds

Federal Capitalization Grant	\$83,993,100
Set aside programs	
Source Water Protection Loan Fund (5 percent)	(\$4,199,655)
**Administration (4 percent)	(banked)
Small Water Systems Technical Assistance (2 percent)	(banked)
Capacity Development (0.4 percent)	(banked)
Balance of Federal grant funds to DWSRF Loan Fund	\$79,793,445
State Match (20 percent)	\$16,798,620
DWSRF Local Assistance (Loan) Funding	\$96,592,065
<i>Reserved (banked) Spending Authority</i>	
**Administration ** (4 percent banked) \$3,359,724	
Small Water Systems Technical Assistance (2 percent banked) \$1,679,862	
Capacity Development (0.4 percent) (banked) \$335,972	

Separate accounts have been established for financial support and accounting of the following set-aside programs:

1. Administration

The federal and state statutes allow the Department to set aside up to 4 percent of the total annual federal Capitalization Grant to support the costs of the administration of the DWSRF program. The Department plans to *bank the authority* to utilize 4 percent allowed from the FFY 2000 grant at a future time if needed.

2. Small Water Systems Technical Assistance

The SDWA authorizes states to set aside up to 2 percent of the total annual federal Capitalization Grant to provide technical assistance to small water systems (those with populations of less than 10,000). As nearly 8,300 of California's 8,700 water systems fall into this category, the Department intends to *bank the authority* to utilize the 2 percent allowed from the FFY 2000 grant at a future time if needed. A specific plan for utilizing these funds will be provided as part of the grant application process if the Department exercises the option to access these funds at a future time. An overview of the process developed by the Department to provide technical assistance to California's small water systems is outlined in Section IV, Set-Aside Activities.

3. Capacity Development

The SDWA encourages states to develop a "capacity development strategy" and sets specific goals and deadlines which states must meet in order to remain eligible to receive both the funds for the capacity development set-aside and to preserve the full Capitalization Grant award in future years. The Department intends to *bank the authority* to utilize the 0.4 percent from the FFY 2000 grant at a future time if needed. A specific plan for utilizing these funds will be provided as part of the grant application process if the Department exercises the option to access these funds at a future time. An overview of the Department's capacity development strategy is set forth in Section IV, Set-Aside Activities.

4. Source Water Protection Fund

The Department intends to allocate 5 percent of the 2000 federal Capitalization Grant to support loans for Source Water Protection Projects (SWPPs). The funding for these loans will be derived under the authorization set forth in Section 1452(k) of the federal SDWA. The Department is implementing a SWPP loan program. EPA approved the Department's Source Water Assessment and Protection Program (dated January 1999) as of April 26, 1999. Repayment of SWPP loans will be directed to the Safe Drinking Water SRF for re-obligation for either water system SRF projects or additional SWPP projects. This program enables community water systems to implement projects directly related to protecting vulnerable water sources from contamination, and can include project funds for land or easement acquisition by community and non-profit non-community water systems. Project proposals cannot address problems for which other sources of funding already exist, such as leaking underground storage tanks.

SWP Projects may involve planning, design, and construction strategies, but may also involve public education, land acquisition, and conservation easements. The type of projects that may be eligible for funding include source water protection measures such as destruction of abandoned wells; hazardous waste collection programs; upgrade or abatement of septic systems; public education; water quality monitoring at critical points in protection areas; fencing out cattle and other animals from intakes, tributaries or reservoir boundaries; restricting public access to critical areas in protection areas; evaluations of agricultural practices and education on best management practices; installation of signs at boundaries of zones or protection areas; land acquisition; conservation easements; and structures to protect the source by diverting contaminated runoff.

C. Eligibility for Funding

The California Legislature followed EPA's DWSRF program guidelines when it established the criteria for public water system eligibility for financial assistance.

1. Eligible Systems

Community water systems, both privately and publicly owned, and non-profit noncommunity water systems are eligible for DWSRF financial assistance. Systems providing water for human consumption through constructed conveyances that have become subject to the SDWA due to the change in the federal definition of a public water system in the 1996 SDWA are also eligible for DWSRF funding. Federally owned water systems are not eligible for DWSRF financial assistance from the State of California. Public water systems located on Indian reservations which accept Department oversight are eligible for DWSRF financial assistance from the State of California. Self-regulated Indian tribal water systems are eligible pursuant to SDWA Section 1452(i) for grant funding from the USEPA for public water system improvement projects.

All of the over 8,700 plus water systems in California were sent an informational letter, pre-application, and instructions both at the time the initial Project Priority List was created in 1997, and again in 1999 when the Department was preparing to update the listing. The process of establishing the Project Priority List is described in more detail in Section VI, Project Priority List. As a result of the Department's dissemination and outreach, 3,473 pre-applications representing 1,627 public water systems were received for the initial listing, and 220 projects were modified or added to the list during the 1999 update.

The DWSRF may not provide any type of assistance to a system that lacks the technical, managerial or financial capability to maintain SDWA compliance, unless the owner or operator of the system agrees to undertake feasible and appropriate changes in operation, and if the use of the financial assistance from the DWSRF will ensure compliance over the long-term (SDWA Section 1452(a)(3)(B)(i)). The Department is implementing a capacity assessment program to evaluate each system to be funded to ensure it has adequate capacity to receive funding.

The Fund may not provide assistance to any system that is in significant noncompliance with any national drinking water regulation or variance unless the State conducts a review and determines that the project will enable the system to return to compliance and the system will maintain an adequate level of technical, managerial and financial capability to maintain compliance (SDWA Section 1452(a)(3)(B)(ii)).

2. Eligible Projects

All eligible projects must facilitate compliance with national or State primary drinking water regulations or further the health protection objectives of the SDWA. There are six types of projects eligible to be funded from the DWSRF loan program. These are listed and briefly described below:

- a. *Compliance and Public Health* - Projects to address SDWA health standards that have been exceeded or to prevent future violations of the rules.
- b. *Projects to Replace Aging Infrastructure* - These include projects to 1) rehabilitate or develop sources; 2) install or upgrade treatment facilities; 3) install or upgrade storage facilities; and 4) install or replace transmission and distribution pipes to prevent contamination caused by leaks, or improve water pressure to safe levels.
- c. *Projects to Provide Treatment Under Section 1401(4)(B) of the SDWA* - Loan assistance to systems affected by the change in the definition of a public water system to include “constructed conveyances” such as canals or other open ditches and certain piped irrigation districts described in SDWA Section 1401(4)(B) for treatment pursuant to SDWA Section 1401(4)(B).
- d. *Land Acquisition* - The acquisition of land is eligible only if it is integral to a project that is needed to meet or maintain compliance or further the public health protection of the SDWA. Land acquisition is only considered eligible if the land is needed as a site for eligible treatment or distribution projects.
- e. *Planning and Design of a Drinking Water Project* - Financial assistance may be given for the costs of project planning, design and other related costs of a Drinking Water project. The cost to applicants of preparing environmental assessment reports may also be included as part of the cost of planning a project. Loans given for this purpose may, at the Department’s discretion, be combined with a later construction loan.
- f. *Consolidation* - Financial assistance may be given to cover the costs of consolidating a public water system, which is in noncompliance with the SDWA or that lacks the necessary technical, financial and managerial capacity to maintain compliance with the SDWA, with another water system that is in compliance to ensure that compliance with the SDWA is achieved and maintained.

3. Growth

Federal and state statutes require that DWSRF funds may not be used for projects whose primary purpose is to provide for or attract growth. Both federal and state requirements do allow an eligible project whose primary purpose is not to address growth, to include a “reasonable” amount of growth that would occur during the useful life of the project. California H&S Code Section 116760.20(j) defines “reasonable growth” as not exceeding 10 percent over the design capacity needed to serve the existing water demand. The primary purpose of a proposed project, as well as the amount of project growth is determined during the departmental review and evaluation of the full project application. DWSRF funding for projects that exceed the 10 percent growth limitation is limited to that amount necessary to comply with the reasonable growth definition. A public water system proposing a project that exceeds this growth limitation will need to identify an alternative source of funding to cover the additional cost associated with excessive project component capacity if the system plans to enter into a DWSRF loan agreement.

D. Types of Financial Assistance Available

In accordance with State and federal statutes and USEPA guidance, several types of financial assistance are offered to eligible project applicants. In order to provide some flexibility for applicants, maintain DWSRF fund long-term viability, and fund as many high priority projects as possible, the Department has developed various terms, limitations, and conditions for use of the funds. These criteria are spelled out in the Departments SRF regulations. Funding assistance of any type will be offered only to projects that are within the fundable portion of the Project Priority List. To the extent feasible, the Department will coordinate SRF funding with funding from other State and Federal sources. Applicants will be encouraged to make maximum utilization of more appropriate funding sources. Available financing options are discussed below.

1. Normal Construction Loans

Normal construction loans comprise the majority of the project financing to be made available and cover planning, design, acquisition, and construction costs. All of the federal rules and criteria apply to these loans. In addition, pursuant to state law, the following terms and conditions apply:

- The maximum length of the loan is 20 years or the useful life of the project, whichever is shorter (H&S Code Section 116761.22)
- The applicable interest rate is 50 percent of the average interest rate paid by the state on general obligation bonds issued in the prior calendar year (H&S Code Section 116761.65).
- The maximum amount of loan financing to be awarded to a single project during any one fiscal year is \$20,000,000 (subject to provisions of CCR Section 63012).

- In addition to the maximum loan amount per project described above, no public water system with multiple projects shall receive a total amount of loans in excess of \$30,000,000 in any one fiscal year (subject to provisions of CCR Section 63012).

2. Planning Loans

Normally, project planning and preliminary engineering costs are included in a design and construction loan and reimbursed to the applicant. However, in a few cases, some smaller systems may not be able to fund the preliminary planning needed to proceed with a full design and construction loan application. In such cases, an applicant may apply for a planning loan. Receiving a planning loan, however, does not commit the Department to future funding of the project and does not guarantee that a subsequent construction loan will be awarded. Projects receiving a planning loan will retain their place on the priority list and will need to compete with other projects for available funding at the time construction is desired.

Planning loans are subject to the following terms and conditions:

- Funds may be used only for feasibility studies, project planning (including environmental documentation), and preliminary engineering. The funds may not be used for detailed design, equipment, acquisition, or construction.
- The project must be within the fundable portion of the project priority list.
- The maximum length of the loan is 5 years. The loan repayments may be combined with a construction loan should one be subsequently awarded. [H&S Code Section 116761.50 (b)(5)]
- The applicable interest rate is 50 percent of the average interest rate paid by the state on general obligation bonds issued in the prior calendar year
- The maximum planning loan amount for any single project shall not exceed \$100,000 per project (CCR Section 63011)
- Subsidized funds are not available for planning studies.
- Planning projects will be considered completed when the final draft planning report is approved by the Department (CCR Section 63011).

3. Disadvantaged Communities

As provided for by state and federal statutes, disadvantaged communities (see discussion under Section V.) may be eligible for additional financial assistance in the form of lower interest rates, extended repayment periods, or forgiveness of principal (subsidy). The loan terms and conditions will be as follows:

- The applicant must be a public agency (CCR Section 63020).

- The loan repayment period will be 20 years, or the useful life of the project constructed, whichever is shorter, except that a disadvantaged system may, if necessary, receive a construction loan of up to 30 years as long as this doesn't exceed the expected useful life of the project.
- The loan repayment period will be 5 years for a planning loan (H&S Code 116761.50)
- The applicable interest rate for both planning loans and construction loans will be zero percent. [H&S Code Section 116761.65 (b)]
- The maximum amount of additional financial subsidy to be awarded to a single public water system in any one fiscal year shall not exceed \$1,000,000. (CCR Section 63021)
- The maximum amount of principal forgiveness per project is 80 percent for categories A through G, 65 percent for projects in categories H through L, and 50 percent for projects in categories M through O (CCR Section 63021).
- In addition to the \$1,000,000 maximum total, forgiveness of principal will not be awarded in excess of \$10,000 per service connection. (CCR Section 630210)

4. Refinancing of Projects

Recently completed projects where the initial debt was incurred and construction started after July 1, 1993, are eligible for refinancing (CCR Section 63000.80) under the following conditions:

- The project must be on the current Project Priority List and fall within the fundable portion of the list.
- The project when constructed complied with all federal DWSRF criteria pertaining to new projects and conformed with all federal cross cutters. The refinancing procedures as specified in the USEPA guidelines will apply.
- Only publicly owned public water systems are eligible.
- The loan maximums and other terms described in subsection III.D.1. (Normal construction loans) shall also apply to refinancing projects.
- Refinancing will be limited to the existing balance of outstanding municipal debt.
- Refinancing will be limited to the high priority categories of A through G which relate to compliance with public health based standards.

5. Local Match Projects

State statutes allow a local agency to pay the required state match (20 percent) in lieu of the state and in return receive a zero interest rate loan. In accordance with USEPA requirements, the Department will require full (100 percent) payback to the state of the project cost, not just the loan amount awarded from federal funds. Thus far no SRF loan applicant has pursued providing a local match nor has interest been expressed in doing so. The Department will impose additional terms and conditions on any local match project consistent with the statutory and regulatory requirement in CCR Sections 63000.49 and 63014; H&S Code 116761.65.

E. Application of Federal Cross-Cutters

There are numerous federal laws and executive orders that apply by their terms to projects receiving Federal financial assistance, even though that assistance may be administered by the State. Examples of these include the National Historic Preservation Act, Wild and Scenic Rivers Act, Equal Employment Opportunity executive orders, Women's and Minority Business Enterprise, and the Endangered Species Act. As the administering agency of California's DWSRF, the Department has the responsibility to assure that applicants adhere to the requirements of these crosscutting laws and orders. The Department established a central unit of specialists in environmental review to assure compliance with the various environmental and historic/archaeological cross-cutting federal requirements. The Department also maintains a support staff providing coordination of MBE/WBE and other non-environmental cross cutters.

Projects supported with funds directly made available by USEPA capitalization grants (*i.e.*, projects funded in amounts equaling the grant), sometimes known as "equivalency projects", must fulfill the Federal crosscutting requirements. The Department retains the discretion to determine which projects are treated as non-equivalency projects. The Department designates projects smaller systems as non-equivalency since smaller systems most often lack the expertise necessary to comply with the more demanding federal equivalency requirements. The Department establishes a cutoff based on the size range and project funding requests anticipated in the funding year pool of SRF projects that will be invited to complete the application process. In the initial two years of the program, the non-equivalency funds (equal to the amount of funding from the State match) were used for systems serving less than 1000 and 200 service connections respectively (including non-community water systems). All SWP projects are funded with federal monies and are subject to federal cross-cutters.

Non-equivalency projects are required to undergo a tier two environmental review, as explained in a later section. Applications sent to water systems seeking funding for projects determined to be non-equivalency projects will explain in detail the requirements applicable to those projects. When projects whose cumulative funding exceeds the amount of the Federal capitalization grant are treated as equivalency projects, the excess will be banked for use in future years.

It should be noted that all projects and activities funded with DWSRF funds are subject to federal anti-discrimination laws, including title VI of the Civil Rights Act of 1964, section 504 of the Rehabilitation Act of 1973, and the Age Discrimination Act of 1975. The Department includes standard provisions concerning these cross cutting laws in all funding agreements and service contracts.

IV. SET-ASIDE ACTIVITIES

The federal SDWA provides for a variety of activities to be funded from the DWSRF using “set-aside” funds to be deposited into separate accounts. While federal statute allows as much as 31 percent of the federal Capitalization Grant to be directed to set-asides activities, at this time the Department plans to utilize only 5 percent for the source water protection loan program. Additional set aside authority totaling 6.4 percent is reserved for possible future program needs as follows:

(1) DWSRF administration costs (4%), (2) small water system technical assistance program (2%), and (3) water system capacity development program (0.4%) from the available federal funds. A summary of the amounts requested in this IUP for set-aside activities is presented in Table 1.

Following is a brief description of each of the proposed set-aside program elements.

A. Program Administration Element

The full cost of administering the Fund, including the development of the priority list, the review and processing of applications from local agencies, management and oversight of individual projects, management of contracts with cooperating agencies, and all accounting and legal costs are funded by this set-aside. The Department does not anticipate instituting any type of loan fee. Therefore, there should be no State administrative cost to a local agency to apply for and secure funding from this program. Public water systems will not be billed for time expended in reviewing and processing applications, although this is allowed by state statute (H&S Code Section 116565).

The administration set-aside funding is used to support staff within the Department and to cover the costs of the interagency agreements with the Department of Water Resources (DWR) and the Bureau of State Audits (BSA). The initial three-year agreement between the Department and DWR will be in its third year during 2000-2001, and the Department anticipates extending the agreement which provides fiscal oversight of SRF loans and grants for SRF and source water protection projects. DHS utilizes a detailed time-accounting system to track hours devoted by staff to the DWSRF program elements. This system forms the basis for drawdowns from the DWSRF administration account.

EPA’s development of the Drinking Water National Information Management System (DWNIMS) database for maintaining information on DWSRF funding and assistance is essentially complete. Pursuant to EPA’s Final Guidelines for the Drinking Water SRF Program (February 1997), the Department provides information to the DWNIMS on a periodic basis. EPA then uses this data to assess the program on a national basis and to monitor state progress in years in which biennial reports are not required. EPA’s regional offices use the information to assist in conducting their annual review of the state program to assess state compliance with the annual grant agreement. They evaluate compliance with special federal requirements and limitations on use of SRF funds, including recipient and project eligibility and the type of assistance provided, and assess the state’s progress in specific tasks identified in the IUP.

The Department utilizes SRF administrative funds to support several data management positions and activities, which in turn support the California's DWSRF program. These data management resources are directed to development of a database for tracking information related to the state DWSRF priority list, the funding process, and project construction. This database, referred to as the Management And Reporting System (MARS) database, is planned to eventually encompass all data tracking functions of the drinking water program. The initial emphasis of this system is capturing data needed for management of the DWSRF program. The system aides program staff in tracking projects designated as subject to compliance with cross cutting federal authorities, the progress of applications toward receipt of funding, and the progress to completion of the project. The information in the database enables staff to determine whether the pace of the program will achieve funding goals for targeted recipients such as small systems and disadvantaged communities. The information is also used when making projections for quarterly payment and cash draw schedules. Rollout of the MARS system initially focused on administrative unit staff. Availability to district office staff is being phased in as site wiring, hardware and software requirements necessary for database utilization can be met.

B. Small Water System Technical Assistance Program Element

California has nearly 8,300 small public water systems (systems serving a population of less than 10,000). As has been well documented over the years, many of these small systems lack the technical capability to be able to comply with the numerous and technically complex requirements of the SDWA. Although the Department, assisted by the local primacy agencies (LPAs), has attempted to assist these small systems, the resources to do so have been extremely limited. Recognizing this condition exists nationally, Congress has provided that up to 2 percent of the federal Capitalization Grant could be used to provide additional technical assistance to small systems. Since the need of the small systems substantially exceeds the allowable 2 percent, the Department intends to apply for the maximum amount available. The Department will use these funds to provide additional in-house technical staff and to contract with LPAs and outside contractors to provide a variety of technical services to small systems in need.

The primary goals of the small system technical assistance program are: (1) reducing the instances of noncompliance with drinking water standards and requirements; (2) establishing and assuring safe and dependable water supplies; (3) improving the operational capability of the systems; and (4) establishing or improving the financial, technical, and managerial capability of the systems. This program is directed at those systems serving a population of less than 10,000, with much of the emphasis given to community water systems serving less than 200 service connections.

The specific work activities to be conducted during FY 2000-2001 will be determined by the Department assisted by LPAs and interested third parties. One of the areas of priority, however, will be to assist small systems in the preparation of applications for DWSRF funding. Preparing these applications, particularly the environmental documentation and preliminary engineering needed, is beyond the technical and financial capability of many systems. The Department, with the help of LPAs and third party contractors will provide some of this assistance.

In addition to the above, the small system technical assistance program will focus on the following activities:

- Source water capacity and demand evaluations (required by the revised California Waterworks Standards)
- Correction of existing or pending violations and other operational problems
- Treatment of source water
- Development of distribution system operational plans
- Operator training (workshops, training materials etc.)

C. Water System Capacity Development Program Element

As discussed under the small system technical assistance program element, many systems have difficulty in understanding and complying with technically complex drinking water requirements. In order for a system to do this effectively it needs the financial wherewithal to adjust and make improvements, the technical knowledge to effectively understand and operate the physical aspects of the system, and the managerial capability to plan and administer overall water system operations. The term “capacity” collectively refers to these three necessary components of water system operation. The purpose, therefore, of this program element is to develop the criteria defining the three operational components and assist water systems in improving their water system operational programs to assure that acceptable levels of operation can be met and sustained.

Essentially, this program element is being implemented in three stages. In the first stage, the Department developed actual criteria for managerial, financial, and technical acceptable performance and to prevent the formation of new water systems that do not meet these criteria. This first stage was completed during the 1998-99 fiscal year. In the second step, the Department assessed existing public water systems in light of the criteria, determine where improvements were needed, and set program assistance priorities. The final step will be to provide actual assistance to those systems most in need of improvements.

A major activity was undertaken to develop a comprehensive state capacity program involving major program elements (i.e. permits for new systems, inspections, operator certifications, training, financial assistance, master planning, technical workshops and assistance). To assist in accomplishing this, the Department sought public participation and established an advisory group of persons representing entities interested in the capacity development program. The Department completed its first draft comprehensive program strategy in *June 2000* which was subjected to public workshops and hearings prior to including it in the 2000 IUP.

Legislation is now in place (H&S Code Section 116540(a)), which allows the Department (effective January 1, 1999) to prevent the formation of a new public water system that does not comply with the capacity criteria. This provision is being implemented through the issuance (or denial) of a domestic water supply permit that must be issued by the Department before a public water system can be operated.

During FY 2000-2001, the Department, with the assistance of LPAs and third party contractors began assessment of existing public water systems for compliance with the adopted capacity criteria. For the most part, this assessment is conducted as part of the annual public water system inspection conducted by the Department or the LPAs.

V. DISADVANTAGED COMMUNITIES

California statutes and regulations provide additional financial assistance to “disadvantaged communities” if such communities cannot afford to repay the full amount of the loan needed to fund the proposed project. The interest rate to disadvantaged communities is set at zero percent (H&S Code Section 116761.65). The assistance may include extending the repayment period to 30 years (but not to exceed the design life) as allowed in the federal act. In addition, for water systems owned by a public agency and serving a disadvantaged community, State law allows forgiveness of up to 80 percent of the loan principle. The entire service area of the public water system must meet the criteria for a disadvantaged community in order for the system to be eligible for consideration for these special financial assistance measures. The provisions of State law allow for assistance so that the resultant water rate to the average residential user is no higher than 1.5 percent of the median household income (MHI) for the community.

Meeting the criteria of a disadvantaged community is the first step in receiving additional financial assistance. Merely meeting the criteria, however, does not guarantee that additional assistance beyond a zero interest loan will be provided. The offer of additional assistance will be dependent upon the disadvantaged community’s ability to repay a loan. Thus, factors such as household income levels, current and projected monthly consumer water charges, and the cost of the proposed project become determining factors.

The determination as to whether a disadvantaged community qualifies for additional financial assistance will not be made until the Department of Water Resources completes its evaluation of the revenue program, project costs, and other financial information contained in the full project application. Therefore, while a public water system may be able to determine in advance whether or not they qualify as a disadvantaged community, they will not know if additional financial assistance will be provided (subject to the limitations described in Section III.D.3.) until the full application process is completed. The process and steps for making these determinations are shown in Figure 2.

The Department assists economically disadvantaged communities in resolving serious drinking water problems consistent with legislative direction. However, the excessive awarding of subsidies would undermine the primary objective of the program, which is to establish a long-term self-sustaining revolving loan fund. Funds given out in the form of subsidy (loan forgiveness) are not returned to the fund in the form of repayments, and so reduce the ability to fund future SRF projects. The Department has balanced these two objectives to meet the overall needs of the program. An ongoing and viable loan program is in the best interest of both financially stable and economically disadvantaged communities. The Department’s success in maintaining an appropriate balance between normal direct loans and additional financial assistance is monitored closely and will be reported to the USEPA in future IUPs.

FINANCIAL NEED DETERMINATION FLOWCHART

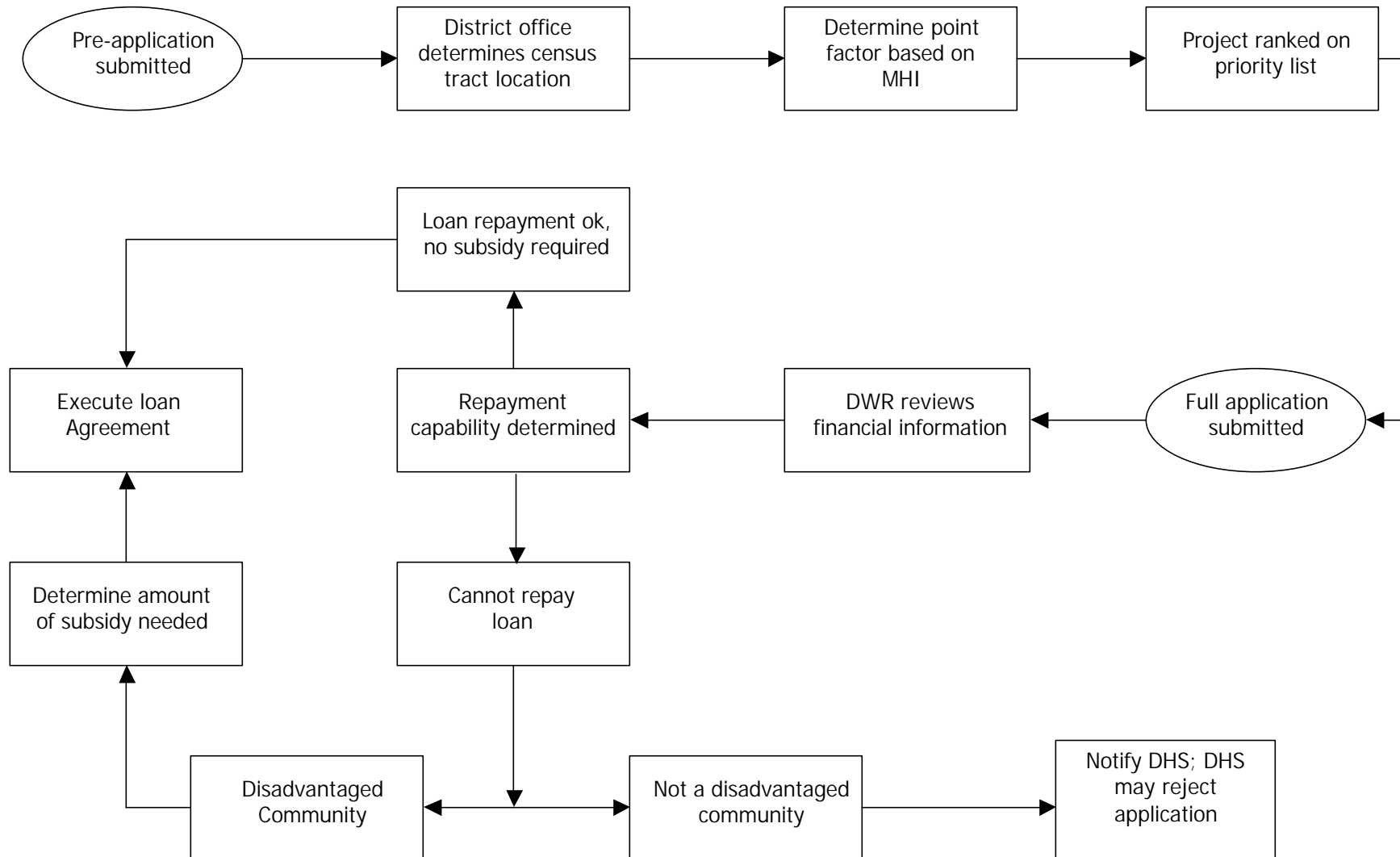


Figure 2

VI. PROJECT PRIORITY LIST

In accordance with federal requirements, all potential recipients for DWSRF funding must have had their projects included on a statewide Project Priority List. The Department developed and adopted a 1999 Updated Project Priority List which was finalized in April 2000 and which will be used for obligating funds from the federal allocation addressed by this IUP. The Department has developed a priority list of source water protection projects, which will serve as the basis for funding source water protection loans under the 5 percent set aside in this IUP for that purpose. Operationally, the Department merges projects that are on an existing priority list with new applications when establishing an updated project priority list. This eliminates the need for many applicants to resubmit applications each list revision cycle. The Project Priority List to be used for the 2000 allocation is attached as **Appendix E**.

Placement of a project on the priority list does not guarantee that a project will be funded. However, only those projects that are included on the priority list will be considered for possible funding. Projects may only be added to a priority list during the annual public hearing and adoption process.

Pursuant to state statutory authority, the Department may revise the ranking of a project on an existing priority list at any time if information affecting the ranking of that project becomes available that was not available at the time the list was adopted.

A. SRF Project Priority Ranking Criteria

1. Health Risk and Safe Drinking Water Act Compliance Categories

As required by federal and state law, water system projects are offered SRF funding based on a Project Priority List developed by the Department. In establishing the priority list, the Department ranks projects in order of the degree of health risk associated with the problem that the proposed project is intended to solve. Thus the projects solving the most serious health risk and SDWA compliance problems receive the highest ranking. When ranking projects, within a category, the Department places smaller systems higher on the list within the category than larger systems, and within each category places systems with lower MHI ahead of non-disadvantaged systems.

The Department has had considerable experience in developing Project Priority Lists using the above criteria (with the exception of “affordability”) in implementing several previous drinking water financial assistance programs. Based on this experience, the Department determined that a category system whereby projects fall into designated categories provides the most feasible and practical way to rank proposed projects. The categories established for the DWSRF program are consistent with USEPA’s criteria and are similar to those categories used during the previous state funding programs. These categories group water quality, quantity, and reliability problems that have a similar degree of health risk. The Department has developed similar ranking criteria for the project priority list for Source Water Protection projects.

The categories that have been established by the Department are briefly summarized below (a more detailed description of the categories is included in **Appendix F**):

<u>Category</u>	<u>Description</u>
A.	Demonstrated illness attributable to the water system or a system under court ordered compliance.
B.	Microbial contamination of the water supply resulting in a repeated coliform bacteria maximum contaminant level (MCL) violation.
C.	Unfiltered surface water or wells that have fecal or E. coli contamination.
D.	Filtered surface water that violates the surface water filtration and disinfection regulation.
E.	Insufficient water source capacity to supply current demand, resulting in water outages or significant water quantity problems.
F.	Nitrate/nitrite contamination exceeding the MCL and Total Coliform Rule violations.
G.	Chemical contamination (other than nitrate/nitrite) exceeding a primary MCL.
H.	Uncovered distribution reservoirs and low-head lines.
I.	Systems meeting existing MCLs but not the proposed microbial MCLs or proposed microbial treatment standards or the California Cryptosporidium Action Plan.
J.	Significant sanitary defects involving sewage.
K.	Disinfection facilities that have defects.
L.	Systems meeting existing MCLs but not proposed non-microbial MCLs.
M.	Other waterworks standards defects.
N.	Iron and/or manganese violations.
O.	Other water system deficiencies.

In general, the Department considers priority categories A through G to be high priority, categories H through K to be medium priority and categories L through O to be low priority.

2. Bonus Ranking Points

Bonus points are used in ranking projects within a category, and the addition of bonus points will not move a project from one category to another. This point is stressed more than once in this document to emphasize that the category in which a project is placed is much more important, for funding concerns, than is the assignment of bonus points. To the extent feasible, when a group of systems is invited to complete the application process for SRF funding, all the systems within that category seeking funding that year are invited.

a. Affordability

The Department factors in affordability using a system similar to that used by the State of New York. This method compares the median household income (MHI) level of the community served by the proposed project to the statewide median household income level. Communities that are below the statewide average median household income level receive additional ranking consideration. This gives poorer communities a higher ranking within a category than communities with higher income levels. Additional affordability ranking points will be granted as follows:

<u>MHI of Service Area</u>	<u>Ranking Points</u>
Greater than the statewide MHI	0
90% - 100% of statewide MHI	5
80% - 89% of statewide MHI	10
70% - 79% of statewide MHI	15
60% - 69% of statewide MHI	20
less than 60% of statewide MHI	25

b. Consolidation

For purposes of ranking projects within a category, any project that includes consolidation of separate existing water systems will receive additional ranking points. Twenty points will be awarded for a physical consolidation of two or more systems and 10 points will be awarded for new consolidation of ownership and/or management (no physical consolidation) of two or more systems. The purpose of assigning consolidation points is to promote reliability, efficiency, and economy of scale that can be achieved with larger water systems while discouraging the

proliferation of numerous separate small systems with their inherent inefficiencies and limitations, consistent with H&S Code Section 116760.10(g).

3.

Type of System

Because there is a relatively higher health risk associated with persons who drink the same water each day over a period of time (accumulated exposure), community and nontransient noncommunity water systems will be ranked above transient noncommunity systems within a category.

4.

Population

Awarding additional ranking points for affordability and consolidation only affects the ranking of a project within a category and will not result in a project being elevated to a higher category. All projects within a category that have the same number of ranking points will be ranked in ascending order based on the population served by the water system with smaller populations ranked above higher populations. This allows smaller communities that have a more difficult time obtaining financing an opportunity to compete with much larger systems for available state financing.

The California Legislature, in adopting Senate Bill 1307, made it clear that the degree of health risk, compliance with the SDWA, and affordability are to be the primary criteria for ranking projects. The ranking criteria described in this section accomplish this. Senate Bill 1307, however, also indicates that the amount of growth included in a proposed project should be considered. To the extent this can be determined at this very preliminary stage of the process, the Department will give consideration to this element. The primary growth evaluation, however, will be made during the review of the full project application when this information becomes available and will, at that time, determine actual funding priorities.

B. Source Water Protection Program Project Ranking Criteria

1. Protection of Water Source from Contaminants Posing a Health Risk

The following categories are used for ranking SWPP projects:

<u>Category</u>	<u>Description</u>
-----------------	--------------------

- | | |
|----|--|
| A. | Source water protection projects that address microbial contaminants associated with potential contaminating activities (PCAs) located in Zone A of a SWP area for a ground water source, or located in Zone A or B of a SWP area for a surface water source if zones have been established. |
| B. | Source water protection projects that address nitrate contamination associated with PCAs located in Zone A for a ground water source. |

- C. Source water protection projects that address nitrate contamination associated with PCAs located in Zones B5, B10 and/or a recharge area for a ground water source.
- D. Source water protection projects that address disinfection byproducts and/or chemicals associated with PCAs located in Zones A and/or B5 for a ground water source, or located in Zones A and/or B for a surface water source if zones have been established.
- E. Source water protection projects that address disinfection byproducts and/or chemicals associated with PCAs in Zone B10 of a ground water source.
- F. Source water protection projects that address disinfection byproducts and/or chemicals associated with PCAs in the watershed of a surface water source.
- G. Source water protection projects that address disinfection byproducts and/or chemicals associated with PCAs in the recharge area of a ground water source.
- H. Source water protection projects that address microbial contaminants associated with PCAs located in Zone B5 and/or B10 for a ground water source, in the recharge area of a ground water source, or in the watershed of a surface water source.
- I. Source water protection projects that address microbial contaminants, nitrates, or disinfection byproducts and/or chemicals associated with PCAs in the buffer zone of a ground water source, if a buffer zone has been established.

2. Bonus Points

SWPP projects will be ranked within a category based on the total number of bonus points awarded by the Department using the following criteria. These criteria provide higher priority to systems in which actual water contamination is known to have occurred and that contamination has shown movement toward the system's water source. The criteria also award points within a category based on actions, which the water system has undertaken on its own to establish a source water protection plan, thereby reflecting a readiness to proceed.

- A. A water system with a source water assessment completed in accordance with the California Source Water Assessment and Protection Program will be awarded 4 bonus points.
- B. A water system that has organized a local task force or work group to develop and implement a source water protection program will be awarded 2 bonus points.
- C. A water system that has developed a source water protection program that identifies possible management measures will be awarded 2 bonus points.
- D. If the contamination from the PCA(s) that the project proposes to address has been released and the direction of movement is toward the drinking water source, the water system will be awarded 3 bonus points.

3. System type and size criteria

Projects in the same category that have the same number of bonus points will be ranked in accordance with the following:

- a) Community and non-transient non-community water system projects will be ranked above transient noncommunity water system projects.
- b) Projects that are proposed by the same type of water system will be ranked in ascending order (smaller populations above higher populations) by the number of persons served.

C. Process for Adoption of Priority List

The ranking of projects on the Project Priority List is based on the submission of a pre-application by public water systems. The pre-application is a relatively simple one-page form that must be filled out and submitted by any water system wishing to have a project included on the priority list. A copy of the pre-application form used by the Department is included as **Appendix G**. A copy of the SWPP pre-application is included as **Appendix H**. In preparing the 1999 updated listing, a copy of the form was sent to all public water systems in California on July 12, 1999 in preparation for the adoption of the 1999 Updated SRF Project Priority List. Since there is no obligation on the part of the water system, all water systems were encouraged to submit pre-applications for any projects for which they might want to consider the use of DWSRF funding in the near future. Water systems are not limited in the number of projects they submit. In fact, systems were encouraged to submit separate pre-applications for each separate water problem faced by the system. During development of the initial (1997) listing the Department received over 3,400 pre-applications. During the development of the 1999 update, new or updated pre-applications were received from 220 systems. The 1999 updated listing included these pre-applications and projects from the 1997 listing, for a total of 3499 projects on the 1999 Project Priority List.

Following receipt of the pre-applications, the Department's district field staff reviewed each project and the project was ranked into the appropriate category. Any bonus points were also assigned and the applicant was informed of the category ranking. This information is entered into a statewide database from which the statewide Project Priority List is developed. A flow chart depicting the pre-application review process is shown in Figure 3.

In addition to individual water system notification, two public hearings were held, one in Sacramento and one in the Los Angeles area. Public comments were taken on the draft 1999 Update of the SRF Project Priority List, and the SWPP Project Priority List as well as the SWPP priority ranking criteria. The Updated Project Priority List for 1999 and the initial SWPP PPL were then adopted. This 1999 Updated SRF Project Priority List is included as **Appendix E**. The SWPP Project Priority List is included as **Appendix I**.

D. Use of the Project Priority List

As indicated earlier, the Project Priority List forms the basis for determining which projects will receive funding. To the extent feasible, projects will be funded in descending order of their placement on the priority list. However, due to the federal deadlines on obligation of the available funds, projects that are not ready to proceed may be by-passed for that particular funding cycle. Any project that is by-passed will retain its position on the priority list and be eligible for the next funding cycle.

Following adoption of the priority list, the Department will determine which projects have indicated an immediate “readiness to proceed”. Readiness to proceed means an ability and willingness to enter into and sign a loan commitment by the deadlines established by the Department for that funding year. The projects that are ready to proceed will be separated into large water system (serving 10,000 or more persons) and small water system (serving less than 10,000 persons) lists. Based on the amount of funding available, the Department will determine which portion of the Project Priority List will constitute the “fundable” portion of the list for that particular funding cycle.

While the fundable project list will include small and large systems and will not exceed the amount of funds available in the loan fund, the Department will identify a number of large systems that together equal 150 percent of the funds available for large systems for that year. This group of large systems will constitute the working list of large systems. The purpose of this working list of large systems is to ensure that there are enough projects ready to proceed at the time the Department initiates the funding by-pass procedures.

Similarly, the Department will identify a number of small systems that together equal 200 percent of the funds available for small systems for that year. A higher percentage goal is used for small systems due to the anticipated higher drop out rate for small systems. This group of small systems will constitute the working group of small systems. The purpose of this list is to ensure that there are enough projects ready to proceed at the time the Department initiates the funding by-pass procedures.

All projects in the working list of large and small systems will be invited to submit a full application for funding from the 2000 funds. The fundable project list for 2000 funding is attached in **Appendix J**. Applications received from large and small systems in the working list, but not in the fundable project list, will be processed as received but funding commitments will not be made until after the by-pass procedures have been initiated, and will be made in order of priority in the Multi-Year Project Priority List. The by-pass procedures occur at multiple times and points in the process. Accordingly, the working list as well as the fundable list will be adjusted periodically based on the by-pass results. A revised fundable list will be submitted to EPA as revisions are made.

As required by the federal guidelines, the Department will annually establish a small water system funding reserve. The purpose of the small system reserve is to assure that small systems do not have to compete with large water systems for available funds and thus would have more time to develop and submit applications without fear of losing funds to larger systems that may

be ready to proceed at an earlier date. The amount of the small system reserve will initially be based on the total cost of small system projects considered to be high priority (categories A through G). The amount of the annual small system reserve will be a minimum of 15 percent of the total funding available for financing projects.

E. Project By-Pass Procedures

As indicated, it may be necessary from time to time for the Department to by-pass a project on the priority list in order to fund a lower ranked project. This is essential to meet the federal funding obligation deadlines and avoid loss of funds. Projects will be by-passed only under one or more of the following conditions:

1. The applicant indicates on the pre-application form that they do not desire or will not be able to receive funding in the current funding year. This project will be by-passed automatically for the current year.
2. Upon receiving an invitation from the Department to submit a full application, the applicant notifies the Department that they do not wish to submit an application at this time or that they cannot meet the application submittal deadline.
3. The applicant fails to submit the full application by the deadline established by the Department.
4. A full application is rejected by the Department and a revised application cannot or will not be resubmitted within the deadlines established by the Department.
5. The Department determines (and has notified the applicant) that the applicant does not (or will not) meet the TMF capacity requirements and is thus ineligible.
6. The water system is in “significant noncompliance”, and it is determined that the project will not return the system to compliance with the SDWA.
7. Upon receiving a letter of loan commitment from the Department, the applicant fails to sign and return the letter by the deadline established by the Department.
8. The applicant fails to submit plans and specifications for the project by the deadline established by the Department and the initial loan offer is withdrawn.
9. The applicant has reached the \$30 million annual per applicant loan cap for projects on the large or small water system fundable lists. All other projects for the applicant that would exceed the \$30 million cap will be by-passed.

Applicants whose projects are, or will be, by-passed will be notified. Any project that is by-passed for any reason will retain its position on the current priority list and will be eligible for potential funding in the following fiscal year.

PRE-APPLICATION REVIEW AND RANKING

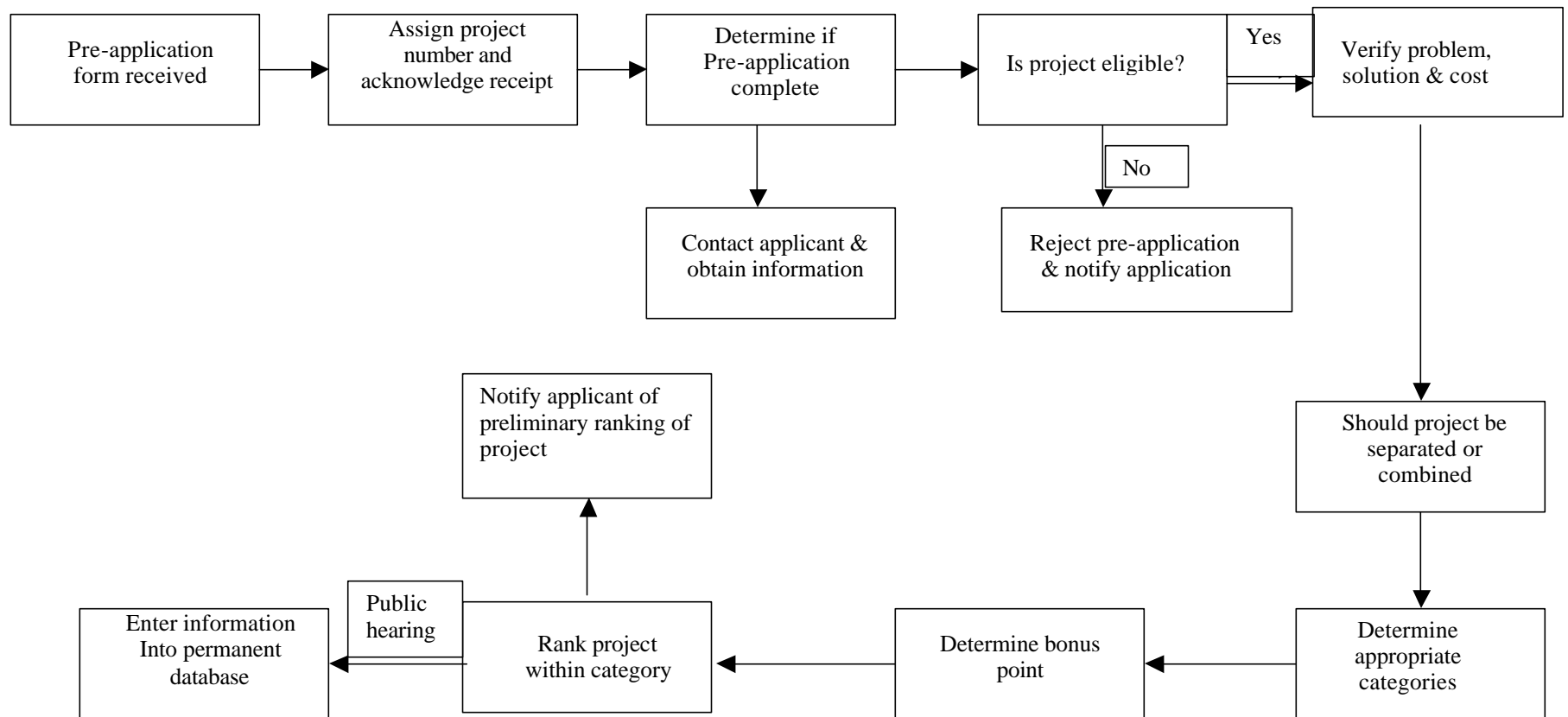


Figure 3

VII. PUBLIC PARTICIPATION

The DWSRF guidelines provided by the USEPA require that states “seek meaningful public review and comment on its funding decisions in the IUP.” The Department has, from the earliest days of planning for its DWSRF program, involved numerous groups and individuals in the development of the ranking criteria and program components. This section provides a summary of the Department’s efforts to involve the public in the development of the DWSRF program.

A. DWSRF Program Development

Initially, the Department met regularly with the “DWSRF Interest Group.” The members of this group represented water associations, state and federal agencies, and other stakeholders interested in the development of the DWSRF. The members of this group reviewed early drafts of the pre-application form, ranking criteria, Project Priority List and the Intended Use Plan. Each member of the group commented on behalf of their own organizations or individual concerns rather than as a team. Thus each was able to make the Department aware of the needs and concerns of their own constituency groups. A list of the members of the DWSRF Interest Group has been previously submitted to the USEPA.

B. Project Priority List and the Intended Use Plan

The draft versions of each year’s Intended Use Plan and each Project Priority List are disseminated to the DWSRF Interest Group and other interested parties prior the publication of the “Final Draft.” Additionally, copies of the Intended Use Plan and the Project Priority List are distributed to individuals, water systems, and other groups who request a copy prior to the publication. Copies of the Intended Use Plan and the Project Priority List are made available for public inspection at the headquarters offices and at each of the Department’s 20 district offices and are made available via the Department’s internet web site.

Two public hearings were held on the 1999 Update of the Project Priority and year 3 IUP. These hearings, at Glendale and Sacramento, along with circulation via mailing, internet, and briefings on the progress of the DWSRF provided interested parties with the opportunity to comment during the development process. Following the workshops, the Department prepared and distributed a summary of questions and comments to the workshop attendees.

C. Source Water Assessment and Protection (SWAP)

The comprehensive description of California’s SWAP is contained in the Department’s Drinking Water Source Assessment and Protection Program report, dated January 1999, which has been submitted previously. The public participation outlined in that document is expected to continue. The Department plans to invite the Policy Advisory Committee and the Technical Advisory Committee to meet annually to receive updates on SWAP activities and to provide input on the future course of these activities.

D. Small Water System Technical Assistance

The small water system technical assistance (SWS-TA) program strategy was developed with the assistance of interested groups such as California Rural Water Association, Rural Community Assistance Corporation, Community Development Block Grant program, California Conference of Directors of Environmental Health (CCDEH), local environmental health agencies, Self-Help Enterprises, American Water Works Association and others. Department staff regularly attend and participate in regional meetings of CCDEH to share information on the SRF program and small water system related topics. These meetings provide a valuable opportunity to integrate public water supply matters with land use, planning, and other environmental health matters.

The Department has reactivated the Small Water Systems Interagency committee and coordinates its quarterly meetings to coincide with those of AWWA's smaller Utilities Committee. These committees act as an advisory group to contractors (such as California Rural Water Association) which are a component of the Department's effort to provide capacity development assistance to public water systems. These meetings also provide a forum for the development of training program requirements related to the State's operator certification program.

E. Capacity Development

During 1999 the Department provided key policy documents to an external group of interested parties, the SRF TAC, in order that these stakeholders could advise the Department on both capacity development and technical assistance activities during the development of this program. This advisory group has met on several occasions. Input from the DWSRF Interest Group, California Conference of Directors of Environmental Health, the LPAs and other committees and task force groups has also been central to the program development process.

In addition to the committees and public meetings described above, Department staff has also made numerous presentations at various meetings and conferences that described the SRF program and solicited input. Additional information regarding public review and comment during the development and implementation of the Department's set-aside programs will be provided in future Intended Use Plans.

As previously noted, on March 7, 2000, voters approved Proposition 13 which was put on the ballot by AB 1584 (Chapter 725, Statutes of 1999). Prop 13, the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act was on the March 7, 2000 statewide ballot (Proposition 13) and was passed by the electorate. This measure allows sales of \$1.97 billion in general obligation state bonds. The Drinking Water SRF will benefit from up to \$70 million of the proceeds of these bond sales. The strong public support for this measure has confirmed the importance which Californians place on the safety and reliability of their water supply.